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Classified By: Economic Counselor D. Burnett for reasons 1.5b and d

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Summary

¶1. (C) The June 29 Joint Economic Development Group (JEDG) meeting presents the opportunity to discuss the eventual severance of the JEDG from its connection to the 2003 Loan Guarantee Agreement (LGA), and its continuance as an annual bilateral economic consultation between the two countries. This would serve several U.S. policy goals, including increasing the GOI,s confidence in its ability to take risks for peace. On substantive issues, the USG delegation should strongly emphasize the importance of the GOI returning to a policy of fiscal restraint, even while expressing understanding for the extreme budgetary measures that have been necessitated by the current global financial crisis. The USG should also support the adoption of a fiscal rule by the GOI tied to the debt-to-GDP ratio as a way to help it make and enforce prudent spending decisions, less subject to the political winds of the moment. The USG should continue to call for budget transparency, but be mindful of the sometimes conflicting forces at play with regard to the issue. Finally, Post supports stressing the importance of GOI modernization and transparency of implementation of food standards by focusing on it as one of the key U.S. conditions for the release of the next tranche of JEDG funds for borrowing by the GOI.

Make JEDG Independent of the LGA

¶2. (C) Embassy discussions with Ministry of Finance (MOF) officials over the past year have indicated that the MOF would like to put the JEDG on a more solid footing, independent of the 2003 Loan Guarantee Agreement. Bank of Israel Governor Stanley Fischer also strongly supports that idea. Recently, there has been a realization on all sides that the LGA program will effectively end if Israel borrows against the funds released by the US for the program and the USG takes deductions from those funds due to Israeli settlement spending. This has caused the MOF to consider ways to institutionalize the JEDG as an annual high-level economic consultative mechanism, akin to the other annual strategic dialogues on military and political issues between the two countries.

¶3. (C) Israel,s economy is not large and does not play a major role in U.S. international trade. However, for several reasons, Post supports continuing the JEDG regardless of the fate of the LGA and suggests that the issue be addressed at the meeting. First, Israel,s high-technology and research and development sector is world-class and of major importance to the U.S. economy. Israel has more companies listed on the

hi-tech-heavy NASDAQ than any country outside of North America. Second, Israel,s economy has performed extremely well over the past five years, and was the only developed economy to experience growth greater than five percent for four consecutive years. At least a part of this success is attributable to U.S. pressure via the LGA to control spending and lower deficits. Continued USG involvement is crucial to maintaining the GOI,s commitment to such policies. Third, a continued and comprehensive economic dialogue would contribute to furthering our peace process goals. USG interest in Israel,s economy would emphasize the comprehensive nature of U.S. support for Israel and potentially make it more willing to take risks for peace. Furthermore, it would give us another avenue to work with the GOI on Palestinian economic development issues, which are key to the success of our policy.

Emphasize Fiscal Restraint

¶4. (C) The 2007 JEDG term sheet, and the 2008 Ariav letter commit the GOI to numerous fiscal targets that appeared reasonable and achievable at the time they were written. However, the worldwide financial crisis has dramatically changed the economic environment and made achievement of most of the targets impossible. Nevertheless, Post suggests a strong U.S. emphasis on the importance of returning to a path of fiscal restraint as soon as possible. By describing the 3.05 percent spending increases called for in the 2009-2010 budget as a 1.7 percent increase with an additional 1.35 percent temporary increase, it,s clear that the GOI is nodding in the direction of the need for fiscal responsibility. However, the way the budget was arrived at, with the MOF officials most interested in restricting spending exercising minimal influence at best, is a danger sign for the future. Therefore, it would be worthwhile to take the opportunity of the JEDG to reiterate that while the worldwide financial crisis has brought about a unique situation which necessitated extreme measures, it does not justify the long-run abandonment of the prudent fiscal policies which contributed so much to Israel,s strong recovery from the 2002 recession and put the country in a strong position to deal with the present crisis.

Adopt a Clear Simple Fiscal Rule

¶5. (C) Part of the GOI,s plan for a return to fiscal restraint involves the adoption of a clear and simple fiscal rule to govern spending. The MOF and Bank of Israel have both been working on developing such a rule and hope to have one in place in time for the 2011 budget deliberations. While there are some differences in their approaches, both agencies foresee spending somehow being tied to the debt to GDP ratio, with the ultimate goal being to lower it to OECD levels. The ratio, which hit as high as 103 percent in 2003, was down below 80 percent before the financial crisis hit and is now inching it way back up to the mid-eighties. Post strongly suggests that one of the main JEDG conditionality planks should involve the adoption of a simple, clear fiscal rule tied to the debt-to-GDP ratio.

Flexibility on Budget Transparency

¶6. (C) Post supports continued emphasis on the issue of budget transparency, keeping in mind, however, that the MOF has conflicting interests on this issue. On the one hand, transparency serves MOF officials in their attempts to exercise greater control over the defense budget. On the other hand, too much transparency would make it more difficult for the MOF to restrain spending by other ministries, which are often unable to withstand MOF dictates due to being in the dark about the details of the GOI,s overall budget situation. Therefore, while transparency

should remain a JEDG issue, the MOF should have some leeway in addressing the issue.

Focus on Food Standards

¶7. (C) Finally, Post believes strongly that addressing the issue of food standards in the JEDG could serve to focus high-level GOI attention on this bilateral trade irritant. For over three years, U.S. food importers have been subject to a confusing regime of licensing and registration procedures that have only worsened with the indictment this past summer of several Ministry of Health workers in the Remedia baby formula case. Guidelines for food products such as infant formula are not published. Labeling and ingredient requirements have been subject to arbitrary delays, and, in some cases, have been outright rejected without prior warning at Israeli ports of entry. In addition, the requirement to store perishable foodstuffs to facilitate batch testing of every product entering the ports has resulted in losses of hundreds of thousands of dollars for U.S. importers. We are requesting that the GOI come up with clear, published, written guidelines on licensing and registration procedures across the board for all U.S. imported food products in compliance with Israel,s WTO commitments.

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